HOUSE OF REPRESENTATIVES
LANSING, MICHIGAN

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Representative Bill Huizenga
Chairman, House Commerce Committee

Dear Representative Huizenga:

As Chair of the Commerce Subcommittee on Long Term Debt and Bonding, I offer the following report to the full Commerce Committee. In your announcement of the creation of this subcommittee, you requested we report back to you on the following points within a 60-day timeframe:

- Past bonding initiatives and their effectiveness
- Debt service from those initiatives and the impact they have had on the State budget
- What measures are/were necessary to enact and implement past bonding initiatives

I am happy to provide this report to you on behalf of the members of the subcommittee within that 60-day timeframe.

Testimony was received from the House Fiscal Agency, the Legislative Service Bureau, the Michigan Department of Treasury and the Michigan Chamber of Commerce. Testimony provided the subcommittee members information explaining the difference between general obligation and revenue bonds, a list of past and current bonds, and the constitutional bond provisions.

In order to begin to understand the bonding process, it is imperative to know the different types of bonds. Here is a listing of categories (compiled from a presentation by the Department of Treasury):

- Duration
    - ⇒ Short term (usually notes)
    - ⇒ Long term
- Issuer
    - ⇒ State/Local
    - ⇒ Transportation Commission
    - ⇒ State Building Authority
    - ⇒ Other Authorities
    - ⇒ Universities and Other Governments
    - ⇒ School Districts

- Source of Payment
    - ⇒ Tax-supported
    - ⇒ Special Assessments (local governments)
    - ⇒ Enterprise Revenues (authorities, local governments)
    - ⇒ Dedicated Revenue Streams (Transportation Commission)
- Purpose
    - ⇒ Refunding
    - ⇒ Cash Flow
    - ⇒ Project
- Security
    - ⇒ General Obligation Unlimited Tax (local governments)
    - ⇒ General Obligation Appropriation Risk (state and local governments)
    - ⇒ Special Obligation (Transportation Commission)
    - ⇒ Revenue
- Terms
    - ⇒ Variable Rate (with or without an option to "put")
    - ⇒ Fixed Rate
    - ⇒ Capital Appreciation
    - ⇒ Serial
    - ⇒ Term
    - ⇒ Convertible or Multimodal

According to the House Fiscal Agency, *general obligation debt* carries the full faith and credit of the state and is backed by the general taxing power of the state. Full faith and credit means the debt is guaranteed by the state's General Fund revenues.

Conversely, *revenue-dedicated debt* does not technically carry the full faith and credit of the state; rather, it is backed by a dedicated revenue stream, such as a specific tax. The state's General Fund does not support the issue of revenue bonds.

Further, it was explained that all debt requirements associated with general obligation bonds are paid from the state General Fund revenues and are appropriated in the Department of Treasury's budget. Debt service on school bond loans is financed from the state General Fund revenues and locally-generated tax revenues.

According to the Legislative Service Bureau, the Michigan Constitution provides the framework for limitations of general obligation bonds and is generally regulated pursuant to sections 14, 15, and 16 of Articles IX. Section 14 allows the state to authorize full faith and credit notes to meet obligations incurred pursuant to appropriations for any fiscal year. As stated by the Legislative Service Bureau, this indebtedness may not exceed 15 percent of the undedicated revenues received by the state in the previous fiscal year. According the constitution, the State of Michigan shall not have any interest in a private company.

The state has bonded according to all three of the sections of the constitution. According to section 14, Article IX the State Treasurer issues bonds for cash flow purposes that must be repaid within the same fiscal year. The state has approved several bonds according to section 15, Article IX such as the Clean Michigan Initiative, the "Quality of Life" Bond Proposal, and the

Great Lakes Water Quality Bond Proposal. Article IX, Section 16 authorized the state to establish of the School Bond Loan Fund.

The following are various means of bonding done by the state to date, and the fiscal impact as well as status of the bond:

- **State Short Term Bonds**
  - Cash Flow Notes
    - Authorized in the Constitution (Article 9, section 14)
    - Approved by the Administrative Board
    - Issued by the State Treasurer
    - Sized as 15% of undedicated revenues from previous fiscal year; payable from all funds
    - Due by the end of fiscal year
    - Outstanding amount is approximately $1.3 billion, payable September 30, 2005

- **State General Obligation Bonds**
  - Authorized by electors
    - Either in Constitution (School Bond Loan Fund {SBLF}); or
    - By separate ballot proposal (Clean Michigan, Water Quality, etc.)
  - Issued when needed
    - Borrow only to meet program appropriations
    - Assure expenditure in 3 years
  - Specific issues approved by the Administrative Board
  - Issued by the State Treasurer
  - In rising interest rate periods, bonds have been fixed-rate bonds to lock in rate
  - In recent years, bonds have been combination of all (multi-modal bonds)

- **Voter Approved Bonds**
  - *Water Resources* (November 1968)
    - Amount authorized: $335 million
    - Amount issued: $335 million
    - First issue, 1970
    - Last issue, 1984
    - Outstanding principal: $0

  - *Public Recreation* (November 1968)
    - Amount authorized: $100 million
    - Amount issued : $100 million
    - First issue, 1970
    - Last issue, 1978
    - Outstanding principal: $0

- *Vietnam Veterans* (November 1974)
  - Amount authorized: $205 million
  - Amount issued: $190 million
  - Issued 1975
  - Outstanding principal: $0

- *Environmental Protection* (November 1988)
  - Amount authorized: $660 million
  - Amount issued: $625 million
  - First issue, 1989
  - Last issue, 2004
  - Remaining authorization: $35 million
  - Outstanding principal: $513 million

- *Recreation* (November 1988)
  - Amount authorized: $140 million
  - Amount issued: $140 million
  - First issue, 1992
  - Last issue, 1995
  - Outstanding principal: $35 million

- *Clean Michigan Initiative* (November 1998)
  - Amount authorized: $675 million
  - Amount issued: $328 million
  - First issue, 1999
  - Last issue, 2004
  - Remaining authorization: $347 million
  - Outstanding principal: $315 million

- *Great Lakes Water Quality* (November 2002)
  - Amount authorized: $1 billion
  - Amount issued: $100 million
  - First issue, 2003
  - Last issue, 2003
  - Remaining authorization: $900 million
  - Outstanding principal: approximately $3 million

- *School Bond Loan Fund*
  - Article 9, section 16 Michigan Constitution
  - School district may borrow, and the State shall lend, to pay debt service on "qualified" school bonds
  - Security is general obligation pledge
  - As of September 30, 2004 - $625 million outstanding

State authorities account for nearly 90% of the total revenue bond debt in Michigan. These authorities include:

- Michigan State Hospital Finance Authority
- Michigan Municipal Bond Authority
- Michigan Strategic Fund
- Michigan State Building Authority
- Michigan State Housing Development Authority
- Michigan Higher Education Student Loan Authority
- Michigan Higher Education Facilities Authority
- Michigan Underground Storage Tank Financial Assistance Authority
- Michigan Broadband Development Authority
- Mackinac Island State Park Commission
- Michigan Family Farm Development Authority

The House Fiscal Agency explained to the subcommittee that the state must meet debt service requirements for general obligation bonds before committing general fund revenue for appropriations. Therefore, as the debt service increases, less general fund dollars are available to spend on other state agencies and programs. The total debt service expenditures since 2000 have been between $85 million and $117 million.

Finally, it is worth noting that over the past few years, the amount of general fund dollars available has been decreasing. In 2000, the general fund had $9.8 billion in revenue and in 2004 it had $8.04 billion in revenue. Therefore, if the number of bonds issued increases and the debt service owed rises, the amount of general fund dollars available for other worthwhile programs continues to decrease.

As you can see from this report, bonding within our state is a complex issue. Each bond category is worthy of time spent not only understanding the bond itself, but the implications of each.

Given the complexity of the issue, it is imperative that I ask you to consider an extension of this Subcommittee to investigate further the issues that arose as a result of seeking the requested information on bonding and its effectiveness. There are numerous areas of importance that should be discussed as we are asked to look at and possibly approve a proposed $2 billion dollar bond.

Respectfully submitted,

Judy Emmons

Representative Judy Emmons
Chair
Bonding and Long-Term Debt Subcommittee